

Boxes

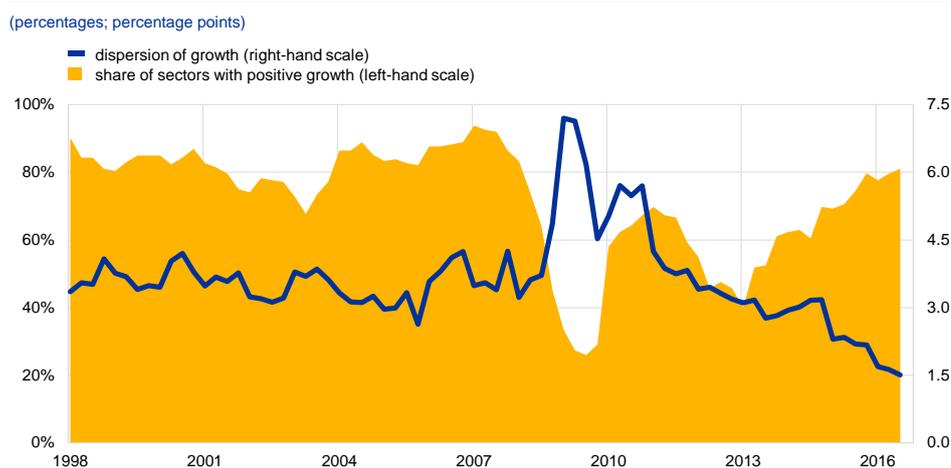
1 Economic growth in the euro area is broadening

Euro area economic growth has been broadening since 2013. Euro area output has been expanding for nearly four years since the recovery began in the second quarter of 2013. Although the recovery has been gradual and moderate, there is evidence that it is becoming more broadly based and firmer, both in terms of country developments and across sectors. This bodes well for economic growth going forward, as expansions tend to be stronger and more resilient when growth is broader. These developments stand in sharp contrast to the short-lived recovery in 2009-10, when growth was relatively uneven.

The economic expansion has reached an increasing number of euro area countries and sectors. Chart A uses value-added data for the nine main economic sectors (excluding agriculture) in 18 euro area countries (excluding Malta), i.e. 162 country-sector pairs. The yellow area in Chart A shows the percentage share of all country-sector pairs with positive year-on-year growth.¹ This measure aims to capture the breadth of the recovery, as small and large countries and sectors are given the same weight. The measure has been rising steadily since 2013, and stood above 80% in the third quarter of 2016, well above both the average of 73% between 1996 and 2016 and the level observed during the 2009-10 recovery.

Chart A

Share of sectors with positive growth and dispersion of value-added growth across countries and sectors



Sources: Eurostat and ECB calculations.

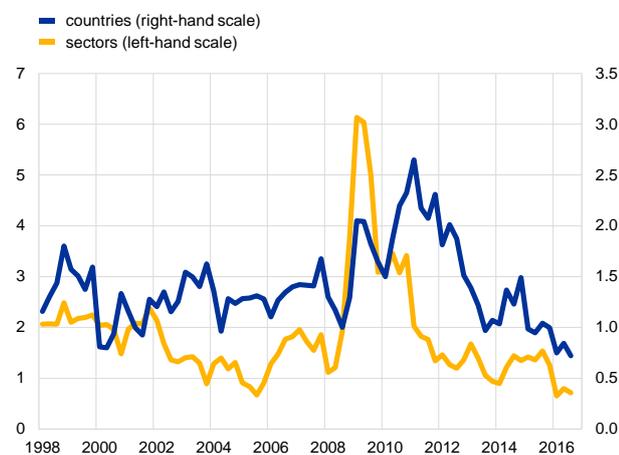
Notes: The share of sectors with positive growth is constructed as the percentage of the 162 country-sector pairs that reported positive year-on-year growth in value added. The dispersion of growth is measured as the weighted standard deviation of year-on-year growth in value added in the same 162 country-sector pairs. The latest observation is for the third quarter of 2016.

¹ A value of 100% would indicate that all sectors in all countries report positive growth, while a value of 0% would indicate declining activity in all sectors in all countries.

Chart B

Dispersion of value-added growth across euro area countries and sectors

(percentage points)



Sources: Eurostat and ECB calculations.

Notes: The dispersion of growth across countries is measured as the weighted standard deviation of year-on-year growth in value added in 18 euro area countries, excluding Malta. The dispersion of growth across sectors is measured as the weighted standard deviation of year-on-year growth in value added in the nine main euro area economic sectors, excluding agriculture. The latest observation is for the third quarter of 2016.

The dispersion of growth across sectors and countries has declined significantly.

Since 2009 the weighted standard deviation of year-on-year value-added growth across the 162 country-sector pairs referred to above has decreased steadily. The peak in dispersion across sectors in 2009 was related to the busts in global trade (i.e. the industrial sector) and in the housing market (i.e. construction), whereas the peak in dispersion across countries in 2011 was related to the sovereign debt crisis (Chart B). The subsequent reduction in the dispersion of growth across countries has largely coincided with a reduction in fragmentation in financing conditions across euro area countries.² In the current recovery, the combined dispersion of value-added growth across sectors and countries has reached levels not seen since the start of EMU. Together with the breadth of the recovery, this suggests that growth has become much more evenly spread across euro area sectors and countries.

The broadening of economic growth is an encouraging development, as it can be seen as a

sign of positive aggregate demand spillovers. Input-output linkages across sectors and trade linkages across countries can create complementarities across activities in sectors and countries.³ This creates a positive relationship between spending in one sector or country and spending in other sectors or countries. Through this demand externality, spending in one sector or country can result in aggregate demand spillovers.⁴ The broadening of economic growth can therefore be seen as a sign that demand is spilling over to an increasing number of sectors and countries, which should further support aggregate demand. This stands in stark contrast to the stubbornly strong dispersion seen during the 2009-10 recovery.

Current economic growth is broader than the recovery in 2009-10 following the financial crisis.

The recovery in 2009-10, which followed the financial crisis, mainly reflected improvements in the industrial sector and "other services". As the bust in the housing market in some euro area countries was still ongoing, the construction sector was still contracting. Since 2013, following the sovereign debt crisis, the recovery has been much broader and now also includes trade services. More recently, even the construction sector has started to expand, in line with the recovery in the housing market (see Charts C and D).

² See also the article "MFI lending rates: pass-through in the time of non-standard monetary policy" in this issue of the Economic Bulletin.

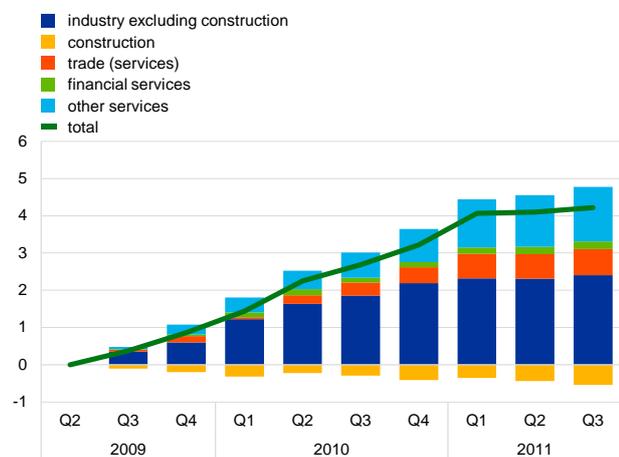
³ See Cooper, R. and John, A., "Coordinating Coordination Failures in Keynesian Models", *The Quarterly Journal of Economics*, Vol. 103, 1988, pp. 441-463.

⁴ See Schleifer, A. and Vishny, R., "The Efficiency of Investment in the Presence of Aggregate Demand Spillovers", *Journal of Political Economy*, Vol. 96, 1988, pp. 1221-1231.

Chart C

Euro area value added during the 2009-10 recovery (following the financial crisis)

(accumulated percentage growth)



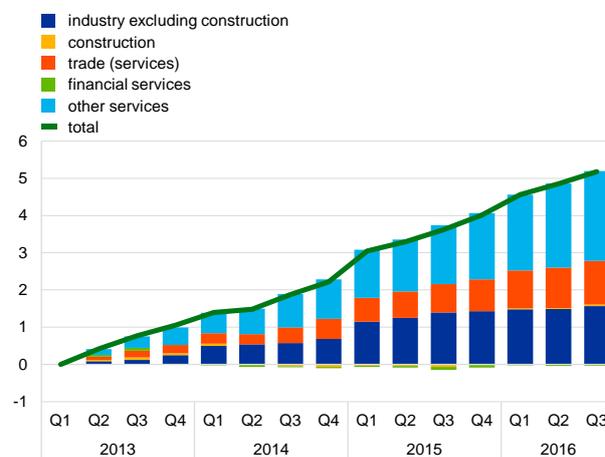
Sources: Eurostat and ECB calculations.

Note: "Other services" includes, for example, information and communication, real estate, scientific and technical activities, public administration, defence, education and health.

Chart D

Euro area value added since 2013 (following the sovereign debt crisis)

(accumulated percentage growth)



Sources: Eurostat and ECB calculations.

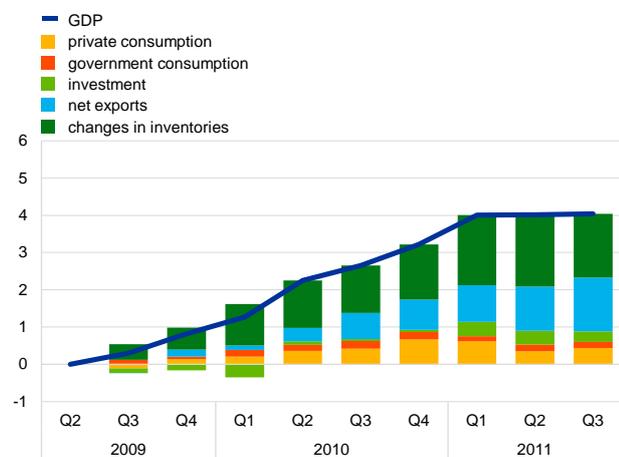
Note: "Other services" includes, for example, information and communication, real estate, scientific and technical activities, public administration, defence, education and health.

Recent growth is being driven more by domestic demand, making the recovery more self-sustained. Another important difference between the recovery that began in 2009 and the current recovery is that the former was largely driven by the upswing in euro area exports. By contrast, the more recent period of growth, starting in 2013, has been driven more by domestic demand and less by foreign demand. In this regard, the current recovery is arguably more self-sustained. In addition, the current growth period is less influenced by changes in inventories, which played a more significant role in the recovery in 2009-10 (see Charts E and F).

Chart E

Euro area GDP and expenditure breakdown during the 2009-10 recovery (following the financial crisis)

(accumulated percentage growth)

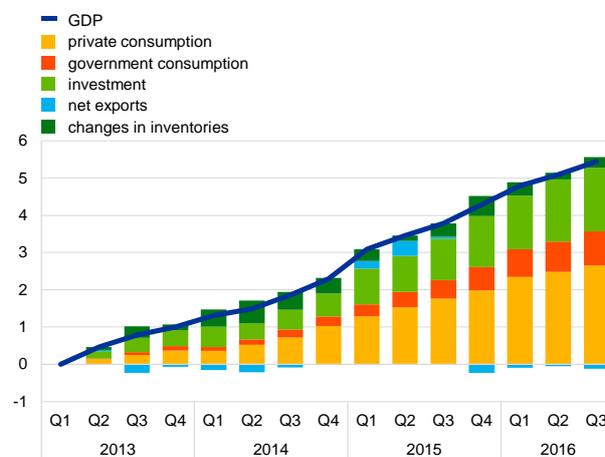


Sources: Eurostat and ECB calculations.

Chart F

Euro area GDP and expenditure breakdown since 2013 (following the sovereign debt crisis)

(accumulated percentage growth)



Sources: Eurostat and ECB calculations.

In line with economic activity, euro area labour markets continued to show broad-based improvements. Euro area employment has been growing since mid-2013 and is now almost back to its pre-crisis level. This contrasts with the recovery in 2009-10, during which headcount employment was still falling. Alongside the recent decline in the dispersion of value-added growth across countries and sectors (Chart A), the dispersion of employment growth has also fallen steadily as the sectoral reallocation of employment has progressed. An improved alignment of labour demand and supply may also imply a decrease in the non-accelerating inflation rate of unemployment (NAIRU).⁵ As labour demand is again shifting towards unemployed workers who were previously employed in sectors that contracted heavily (e.g. construction), wage pressures might still remain muted for some time to come.

⁵ See Lilien, D., "Sectoral Shifts and Cyclical Unemployment", *Journal of Political Economy*, Vol. 90, 1982, pp. 777-793.